TRAPPER MINING INC.

IBLA 94-248 Decided May 29, 1998

Appeal from a Decision of the Deputy Director, Minerals Management Service, affirming a decision requiring a coal lessee to include the cost of primary crushing in its gross proceeds, for royalty valuation purposes. MMS-91-0113-MIN.

Affirmed.

1. Coal Leases and Permits: Royalties

In the case of coal extracted, removed, and sold from a Federal coal lease from June 1, 1988, to Mar. 1, 1989, MMS properly requires the lessee to add the cost of primary crushing to the contract sales price for royalty valuation purposes even though the cost was borne by the buyer after the sale. This addition to the sales price was required by the regulation in effect during that time period, 30 C.F.R. § 203.250(h) (1988).

2. Coal Leases and Permits: Royalties

In the case of coal extracted, removed, and sold from a Federal coal lease from Mar. 1, 1989, to Aug. 15, 1990, MMS properly requires the lessee, pursuant to 30 C.F.R. § 206.257(h) (1990), to include the cost of primary crushing in gross proceeds accruing to the lessee, for royalty valuation purposes, even though the cost was borne by the buyer after the sale. The preponderance of the evidence demonstrates that primary crushing was necessary to place the coal in a marketable condition, i.e., in a condition that it would be accepted by a purchaser under a sales contract typical for the geographic region in which coal has similar quality and economic characteristics.

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OPINION BY ADMINISTRATIVE JUDGE FRAZIER

Trapper Mining Inc. (Trapper) has appealed from a September 27, 1993, Decision of the Deputy Director, Minerals Management Service (MMS), affirming an August 15, 1990, Decision of the Chief, Royalty Valuation and Standards Division (RVSD), MMS, requiring Trapper to recalculate the royalty value of close to 2.5 million tons of coal extracted, removed, and sold from its Federal coal leases, C-07518 and C-25948, during the period from June 1, 1988, through August 15, 1990. The coal was sold to the four owner/operators of a nearby coal-burning electric power generating station in Craig, Colorado (Craig Station). 1/ MMS required Trapper to include the cost of primary crushing in the value of the coal for royalty purposes, despite the fact that the coal was actually sold in an uncrushed "run-of-mine" state.

The coal at issue here was sold by Trapper under the "Craig Station Fuel Agreement" (1973 Fuel Agreement), which had originally been executed by UII, Trapper's predecessor-in-interest, as the Seller, and Colorado-Ute et al., as the Buyers, on March 1, 1973. That agreement provided that, during its over 40-year term, "uncrushed run-of-mine coal" would be delivered from various Federal, state, county, and private coal leases, eventually including Federal lease Nos. C-07518 and C-25948, to the Craig Station and there weighed, sampled, and sold, at a specified price per million Btu (British thermal unit), subject to escalation tied to future increases in mining and related costs. (1973 Fuel Agreement at 12.) Following the sale, the coal was crushed at the Craig Station facility at Colorado-Ute et al.'s expense before being further processed and used for electric power

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1/ Federal coal lease Nos. C-07519, C-079641, and C-813 and the two leases at issue here make up the "Trapper Mine," a strip mining operation, situated in Moffat County, Colorado. They were originally issued to the Utah Construction Company (now Utah International Inc. (UII)) in 1958 (C-07518) and to UII in 1980 (C-25948), and, at the time of the Aug. 15, 1990, Decision of the Chief, RVSD, Trapper, the sublessee, was in the process of acquiring both leases by assignment from the holder of the leases (General Electric Holdings, Inc.). Coal has been produced and sold from lease No. C-07518 since June 1979 and from lease No. C-25948 between January 1, and August 31, 1989. (Decision at 1.) No coal has been produced or sold from the other three leases. (SOR at 1 n.1.) During the period at issue, Trapper was required to pay 12.5 percent of the "value" of the coal produced from the surface of the leased land "as set forth in the regulations." The owner/operators of the Craig Station are four electric utilities, Colorado-Ute Electric Association, Inc., Platte River Municipal Power Association, Tri-State Generation and Transmission Association, Inc., and Salt River Project Agricultural Improvement and Power District (hereinafter, collectively, Colorado-Ute et al.).

generating purposes. 2/ Trapper succeeded, by assignment, to UII's interest under the 1973 Fuel Agreement on July 20, 1983. 3/

In his August 15, 1990, Decision, the Chief, RVSD, concluded that the sales price received by Trapper under the 1973 Fuel Agreement did not represent the full value of the coal produced and sold from its Federal leases to Colorado-Ute et al., for Federal royalty purposes, since the sales price did not reflect the "total consideration" received by Trapper for the sale of the coal. (Decision, dated Aug. 15, 1990, at 1.) He held that, for royalty valuation purposes, the "gross proceeds" received for the sale must include the "consideration attributable to the crushing facility." Id. at 2. MMS reasoned that, since the cost associated with primary crushing would normally be performed as a part of a lessee's mining operations necessary to place its coal in a marketable condition, that cost was actually borne by Colorado-Ute et al. for the benefit of, and should be attributable to, Trapper for royalty valuation purposes. (Findings at 8-9.) The Chief's conclusion that primary crushing was necessary to place the coal from Trapper's leases in a marketable condition was based on the fact that, of the six other mines in the "Green River Hams Fork coal production region," all but one sold the coal in a crushed condition. (Findings at 3.) MMS noted that it had "survey[ed] * * * other mines in the Green River Hams Fork coal production region * * * to determine the condition of the coal at the point of sale." 4/ Id. As later summarized by the Deputy Director, the Chief held:

> [B]ecause the buyers are providing a non-cash benefit to Trapper in addition to the invoice price by crushing the run-of-mine coal at no cost to Trapper, the incremental value [represented by the cost of crushing, which would ordinarily be included in the

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2/ The run-of-mine coal, which ranges in size from powder fines to 8-inch diameter, is primary crushed by Colorado-Ute et al. to about "3-inch minus" at the Craig Station. ("Findings and Conclusions on Product Valuation" (Findings), Enclosure 1 attached to Decision of Chief, RVSD, dated Aug. 15, 1990, at 2.)

3/ We are informed that Trapper was later wholly acquired, through the purchase of the stock of its parent corporation (Williams Fork Company, Inc.), by Colorado-Ute et al. (Statement of Reasons on Appeal (SOR) at 2.) It is unclear as to when this occurred. MMS and Trapper agree that the 1973 Fuel Agreement itself was negotiated at arm's length. See Decision of Chief, RVSD, dated Aug. 15, 1990, at 2 ("arm's-length contract"); Answer at 1; SOR at 2, 6-7, 9; SOR to Director, MMS, at 9-11; Response to RVSD's Field Report at 3. MMS maintains that the contract became nonarm's-length when Trapper affiliated with Colorado-Ute et al. See Memorandum from Chief, RVSD (Field Report), dated Mar. 28, 1991, at 8-9.

4/ These mines are Colowyo, CYVCC (including the Twenty Mile and Energy Strip), Deserado, Empire (including the Eagle Nos. 5 and 9), Kerr, and Senneca II. Of these mines, only the Senneca II sold "Run-of-Mine" coal; the remainder sold "Crushed" or "Crushed/Washed" coal. (Findings at 3.)

invoice price,] must be added to [that] price to reflect the full value accruing to the lessee. [5/]

(Decision at 2-3; see Decision of Chief, RVSD, dated Aug. 15, 1990, at 1-2; Findings at 9.) Trapper timely appealed to the Director, MMS, pursuant to 30 C.F.R. § 290.3 (1991).

In determining the proper value of the coal produced and sold from Trapper's leases for royalty purposes, it is important to consider the exact date of production and sale, since different regulations are applicable, depending on when production and sale occurred. Thus, for coal produced and sold during the period from June 1, 1988, to March 1, 1989, the applicable regulation is 30 C.F.R. § 203.250 (1988). The Department amended its royalty valuation regulations, effective March 1, 1989, 54 Fed. Reg. 1491, 1522 (Jan. 13, 1989), and the applicable regulation for coal produced and sold during the period from March 1, 1989, to August 15, 1990, is 30 C.F.R. § 206.257 (1990).

In her September 1993 Decision, the Deputy Director affirmed the August 1990 Decision of the Chief, RVSD. With respect to the period prior to amendment of the regulations, she concluded that 30 C.F.R. § 203.250(h) (1988) required Trapper to add the cost of primary crushing to the contract sales price when calculating the value of coal for royalty purposes, even where this cost was borne by the buyer: "[T]he lessee cannot evade th[e] proscription by taking the equivalent of a primary crushing deduction by accepting a reduced price for coal from a purchaser who assumes the cost[] for this phase of the preparation for market." (Decision at 8.) With respect to the period from March 1, 1989, to August 15, 1990, the Deputy Director held that Trapper had failed to demonstrate that primary crushing was not necessary to place the coal in a marketable condition: "[T]he record does not contain sufficient evidence that an established market exists for the run-of-mine coal sold by [Trapper]. The fact that there is one other mine in the region that sold run-of-mine production is not sufficient evidence that an established market exists." (Decision at 5-6.) Thus, the Deputy Director concluded that, under amended 30 C.F.R. § 206.257(h) (1990), MMS properly required Trapper to include the cost of primary crushing in the gross proceeds for the coal, to arrive at the gross value for royalty purposes. (Decision at 9.)

[1] During that time period from June 1, 1988, to March 1, 1989, 30 C.F.R. § 203.250 (1988) provided that the "value of coal for Federal

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5/ To permit MMS to determine the incremental value attributable to the primary crushing cost, the Chief directed Trapper to provide information to MMS for the period from June 1, 1988, through Aug. 15, 1990, including the costs of labor, materials, and supplies involved in operating and maintaining the crushing facility and property taxes, insurance costs, and amortized capital costs for the facility.

royalty purposes shall be the gross value at the point of sale." 30 C.F.R. § 203.250(f) (1988). Regulation 30 C.F.R. § 203.250(g) (1988), in turn, defined what constituted "gross value":

> The gross value shall be the unit sale or contract price times the number of units sold, unless MMS determines that:
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> (1) A contract of sale or other business arrangement between the operator/lessee and a purchaser of some or all of the coal produced from the Federal lease is not a bona fide transaction between independent parties because it is based in whole or in part upon considerations other than the value of the coal; or
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> (2) No consideration is received from some or all of such coal because the operator/lessee is consuming such coal or adding it to inventories, and for which Federal royalty is due and payable.

(Emphasis added.) Thus, except in the case of either a nonbona fide arm's- length transaction or coal consumed or added to inventories, see Lone Star Steel Co., 117 IBLA 96 (1990), Federal royalty will be determined on the basis of the contract sales price.

However, 30 C.F.R. § 203.250(f) (1988) also contained an important exception to what constitutes the "value of coal for Federal royalty purposes." Thus, it provided that value "shall be the gross value at the point of sale * * * except as provided at 30 CFR 203.2[5]0(h) [(1988)]." 6/ 30 C.F.R. § 203.250(f) (1988) (emphasis added). That regulation provided, in pertinent part:

> If additional preparation of the coal is performed prior to sale, such costs shall be deducted from the gross value in determining value for Federal royalty purposes. * * * However, the following shall not be deducted from the gross value in determining value for Federal royalty purposes: costs of primary crushing, storing, and loading; treatment with chemicals to prevent freezing; treatment with oil to suppress dust in transit; and, other preparation of the coal which in the judgment of [MMS] does not enhance the quality of the coal.

30 C.F.R. § 203.250(h) (1988) (emphasis added).

6/ Subsection (f) of 30 C.F.R. § 203.250 (1988) actually cited to "30 CFR 203.200(h) [(1988)]." There was no such regulation in effect at that time. However, it is clear that subsection (f) intended to cite to 30 C.F.R. 203.250(h) (1988), since that regulation was a redesignation of 30 C.F.R. § 203.200(h) (1983), and, like it, listed those costs which could and could not be deducted. See 53 Fed. Reg. 1218 (Jan. 15, 1988). MMS and Trapper agree. (Findings at 5; SOR to Director, MMS, at 7.)

Regulation 30 C.F.R. § 203.250(h) (1988) precludes deduction of the cost of primary crushing of coal from gross value for royalty purposes, when such cost is incurred by the lessee in preparing the coal "prior to sale." Cf. Western Fuels-Utah, Inc., 130 IBLA 18, 30-31 (1994) (costs of transporting coal to off-lease loadout facility); FMC Corp., 54 IBLA 77, 81 (1981) (costs to produce finished soda ash). We conclude that the regulation is equally applicable to require the addition of those costs to the actual sales price when those costs are incurred after the sale. Cf. Texaco Inc., 134 IBLA 109, 113-15 (1995) (costs of removing hydrogen sulfide from natural gas). The cost of primary crushing is, because it is deemed necessary to place the coal in a marketable condition under 30 C.F.R. § 203.250(h) (1988), considered the sole responsibility of the lessee, regardless of whether the crushing is performed by the lessee or the lessee's buyer or whether the crushing occurred on or off the lease site. Cf. Texaco Inc., 134 IBLA at 114 (citing Apache Corp., 127 IBLA 125, 134 (1993)); R.E. Yarbrough & Co., 122 IBLA 217, 220-22 (1992) (costs of gathering and compressing natural gas). If the cost of primary crushing is not added to the contract sales price for royalty valuation purposes, such cost is effectively deducted from gross value. Peabody Coal Co., 139 IBLA 165, 171 (1997) (capital costs of loadout facility).

Reducing the gross value for royalty purposes effectively requires the Federal Government to bear some of that cost. That is clearly not permitted under the longstanding "Market Condition Rule," which was in effect at the time of 30 C.F.R. § 203.250(h) (1988). See 54 Fed. Reg. 1517 (Jan. 13, 1989) ("MMS * * * ha[s] always required that lessees place lease production in marketable condition without cost to the Federal * * * lessor"); cf. Mesa Operating Limited Partnership v. U.S. Department of Interior, 931 F.2d 318, 324-25 (5th Cir. 1991), cert. denied, 502 U.S. 1058 (1992) (costs of treating natural gas); California Co. v. Udall, 296 F.2d 384, 386-88 (D.C. Cir. 1961) (costs of compressing and treating natural gas); Texaco Inc., 134 IBLA at 115 (costs of removing hydrogen sulfide from natural gas); Apache Corp., 127 IBLA at 134 (costs of removing hydrogen sulfide from natural gas); TXP Operating Co., 115 IBLA 195, 202-04 (1990) (costs of storage and handling of natural gas condensate).

Trapper contends that MMS was required by 30 C.F.R. § 203.250(f) and (g) (1988) to value the coal produced and sold from its leases according to the contract sales price, unless the sales contract was either "not a bona fide transaction between independent parties," 30 C.F.R. § 203.250(g)(1) (1988), or the producer was "consuming [the] coal or adding it to inventories," 30 C.F.R. § 203.250(g)(2) (1988). 7/ Trapper argues that, since neither situation exists, MMS was required to use the contract sales price.

7/ In the absence of a bona fide arm's-length transaction or coal consumed or added to inventory, 30 C.F.R. § 203.250(g) (1988) required that MMS determine "gross value" taking into account other factors, including the consideration received by the lessee in other related transactions, the average price paid for coal of like quality produced from the same general area, prices under comparable contracts, mining cost plus a reasonable profit margin, and prices reported to a public utility commission and/or the Federal Energy Regulatory Commission.

We agree that neither of the two exceptions to the contract sales price requirement of 30 C.F.R. § 203.250(f) and (g) (1988), as set forth in subsections (g)(1) and (2), is applicable to the present situation. However, 30 C.F.R. § 203.250(h) (1988) also constitutes an exception to that requirement. 30 C.F.R. § 203.250(f) (1988). That regulation dictates that adjustments be made to the contract sales price to arrive at the final value of the coal for royalty purposes. Thus, it provides that the costs of "prepar[ing] * * * the coal * * * shall be deducted from the gross value in determining value for Federal royalty purposes." 30 C.F.R. § 203.250(h) (1988). However, it then specifically precludes the deduction of certain of these preparation costs, including the "costs of primary crushing." Id.

It is therefore clear that determining whether, under 30 C.F.R. § 203.250(g) (1988), the contract sales price can be used for royalty purposes or whether either of the two principal exceptions thereto is applicable does not end the controversy. MMS must also determine whether the contract sales price should be adjusted under 30 C.F.R. § 203.250(h) (1988) to determine gross value. Peabody Coal Co., 139 IBLA at 170. It did so here, concluding that the cost of primary crushing must, in accordance with 30 C.F.R. § 203.250(h) (1988), be added to the contract sales price to determine gross value for royalty valuation purposes. Trapper provides no basis for overturning that conclusion.

Thus, we affirm the September 1993 Decision of the Deputy Director, to the extent she affirmed MMS' determination that the cost of primary crushing of coal sold from Trapper's leases from June 1, 1988, to March 1, 1989, should be added to the contract sales price for royalty valuation purposes.

[2] With respect to coal sales during the period from March 1, 1989, to August 15, 1990, 30 C.F.R. § 206.257 (1990) provided that the "value of coal that is sold pursuant to an arm's-length contract shall be the gross proceeds acc[ru]ing to the lessee." 30 C.F.R. § 206.257(b)(1) (1990). Further, 30 C.F.R. § 206.257(g) (1990) provided that "under no circumstances shall the value for royalty purposes be less than the gross proceeds accruing to the lessee." Thus, in the case of coal sold under arm's-length contracts, it will generally be valued for royalty purposes according to the contract sales price and "other consideration" accruing to the lessee. 30 C.F.R. § 206.251 (1990).

Gross proceeds was further defined to include "payments to the lessee for certain services such as crushing, sizing, screening, storing, mixing, loading, treatment with substances including chemicals or oils, and other preparation of the coal to the extent that the lessee is obligated to perform them at no cost to the Federal Government." 30 C.F.R. § 206.251 (1990). 8/ Moreover, for our purposes here, 30 C.F.R. § 206.257(h) (1990) provided, in pertinent part:

8/ Regulation 30 C.F.R. § 206.251 (1990) covers the situation where the lessee performs "services," such as primary crushing, and is reimbursed by its buyer. Where the crushing was necessary to place the coal in a

> The lessee is required to place coal in marketable condition at no cost to the Federal Government * * *. Where the value established pursuant to [30 C.F.R. § 206.257 (1990)] is determined by a lessee's gross proceeds, that value shall be increased to the extent that the gross proceeds has been reduced because the purchaser, or any other person, is providing certain services, the cost of which ordinarily is the responsibility of the lessee to place the coal in marketable condition.

(Emphasis added.) Coal is deemed to be in "marketable condition" when it is "sufficiently free from impurities and otherwise in a condition that it will be accepted by a purchaser under a sales contract typical for th[e] area." "Area" is defined as the "geographic region in which coal has similar quality and economic characteristics." 30 C.F.R. § 206.251 (1990).

Thus, the question for determination here is whether the coal produced and sold from Trapper's leases to Colorado-Ute et al. was in a "marketable condition," at the time of sale, and accepted by a purchaser under a typical sales contract for the area, without primary crushing. If it was in a marketable condition, the cost of such crushing would not need to be included in the gross proceeds for royalty valuation purposes. However, if it was necessary to primary crush the coal to place it into a marketable condition, the cost of doing so is properly added to the contract sales price to determine gross proceeds for royalty purposes.

Whether the subject coal was in a marketable condition when it was sold is not determined by whether Colorado-Ute et al. were willing to accept the coal in its uncrushed run-of-mine condition. Rather, we must look to whether the coal would be "accepted by a purchaser under a sales contract typical for th[e] area," i.e., the "geographic region in which coal has similar quality and economic characteristics." 30 C.F.R. § 206.251 (1990) (emphasis added). This was explained in the preamble to the 1989 rulemaking that resulted in promulgation of the regulations barring the Federal Government from bearing any of the costs of placing coal in a marketable condition:

> The requirement that the lessee place the lease product in marketable condition at no expense to the lessor is a vital royalty concept. It defines the minimum level of effort and expenditure the lessee must undertake to place leasehold production in merchantable condition without any contribution or sharing of expenses by the lessor. Any further processing activity beyond that necessary for placing the lease product in marketable condition would be a derivative of the lessee's

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fn. 8 (continued)
marketable condition, the lessee would be required to include that reimbursement when valuing the coal for royalty purposes, since the lessee would, in accordance with 30 C.F.R. § 206.257(h) (1990), be required to accomplish that task "at no cost to the Federal Government." 30 C.F.R. § 206.251 (1990).

contractual sales obligation. From a royalty perspective, the additional processing would ostensibly qualify for a deduction from royalties accruing from the sale of leasehold production that has undergone processing beyond that necessary to prepare the mineral as a marketable product.

Marketable condition is the form and condition of leasehold production resulting from the application of normal mining processes. The established market demands and expects that lease production be in such a condition that it can be accommodated by existing buyer facilities used for receipt, handling, and consumption of leasehold production. With respect to coal, processes commonly applied by mine operators (or lessees) to prepare coal for the market include all operations which extract, sever, or otherwise separate coal from its in-place position in the geologic strata; crushing (to limit upward size), sizing, storing, blending, and loading for shipment (including oiling); and all transportation requirements in and about the mine beginning at the point of extraction and including movement to all plants and facilities in which normal mining processes are applied.

Processes which are not identified with common mine operations or practices include * * * operations involving the physical processing of coal to a condition of quality beyond that normally attributed [to] or associated with coal marketed from the same area.

However, the conditioning of coal for the market does not consist of a uniform set of processes. Rather, the marketable condition requirement is as flexible as the requirements of different market segments. For example, some types of coal sold to certain market segments are not normally screened. Instead, the run-of-mine coal is passed through a crusher to reduce the large pieces. The result of this size reduction is prepared coal that can be accommodated by both seller (lessee) and buyer's coal handling facilities. In other situations where coal fines present problems, the marketable condition requirement for coal will include screening, to eliminate the specified coal fines fraction.

Therefore, the test of marketable condition relies on: (1) The market segment that coal is sold into; (2) the customary requirements of preparation and conditioning normally expected by that market segment; and (3) the typical level of preparation and conditioning by coal producers in that area.

Therefore, under no circumstances will MMS accept the gross proceeds established under any sale of coal that does not meet the market's minimum requirement for marketable condition.

> Specifically, the sale of run-of-mine coal for steam coal utilization by an electric utility does not constitute coal in marketable condition. [9/] In this situation, MMS will add to the gross proceeds the cost of those normal mining processes which are ordinarily the responsibility of the lessee.

54 Fed. Reg. 1498-99 (Jan. 13, 1989) (emphasis added).

In the present case, MMS determined that the applicable "area" for assessing what "condition" of coal would be "accepted" by a purchaser under a typical sales contract, within the meaning of 30 C.F.R. § 206.251 (1990), was the "Green River Hams Fork coal production region." 10/ (Findings at 3; see Decision at 2, 6.) Trapper does not dispute MMS' determination. 11/ We find no basis to overturn MMS.

The only real question is whether, uncrushed run-of-mine coal would be "accepted by a purchaser under a sales contract typical for" the Green River Hams Fork coal production region. 30 C.F.R. § 206.251 (1990). Noting that only one of the six other mines selling coal into the electric power generating market in that region (which is the "market segment" for that coal, 54 Fed. Reg. 1498 (Jan. 13, 1989)) sold uncrushed run-of-mine coal, MMS plainly found that coal must be primary crushed to be accepted under a "typical" sales contract in that area. (Decision at 6; see Findings at 2, 8; Field Report at 16, 17, 18-19.) Trapper offers no persuasive evidence to the contrary. 12/

9/ This statement indicates that, in all cases, the Department regards run-of-mine coal sold for electric power generating purposes as not being in a marketable condition. This statement agrees with the Department's intent expressed when 30 C.F.R. § 206.257(h) (1990) was published as a proposed rule. See 52 Fed. Reg. 1844 (Jan. 15, 1987) ("[The proposed rule] expressly retains the existing requirement that coal operations such as crushing * * * are costs incurred to place the coal in marketable condition and are to be borne exclusively by the lessee"). However, this per se rule was not incorporated in the regulations, and we decline to find that this is true in all situations. As the final preamble generally instructs, MMS must look to actual market circumstances. Cf. Exxon Corp., 118 IBLA 221, 242, 98 I.D. 110, 120-21 (1991) (dehydrated gas); Order, Beartooth Oil & Gas Co. v. Lujan, No. CV 92-99-BLG-RWA (D. Mont. Sept. 22, 1993), at 5, 10 (uncompressed gas).

10/ MMS also states that the area, which encompasses portions of Moffat and Routt counties, is also called the "Yampa [Coal] Field." (Field Report at 10.)

11/ Trapper does suggest that, for purposes of 30 C.F.R. § 206.251 (1990), the "area" in the instant case consists of only those mines selling to what are termed "mine-mouth" electric power generating stations. (SOR to Director, MMS, at 16; Response to RVSD's Field Report at 2, 6.) We can find no sanction for this approach.

12/ At best, Trapper argues that the fact that two mines, including its mine, sell coal in an uncrushed condition constitutes a "significant, if minority segment of production in the region." (SOR at 10.) However, we

We appreciate Trapper's argument that there are a number of sound practical and business reasons for Colorado-Ute et al. to engage in primary crushing at their own expense, and that ultimately this was done at the insistence and for the convenience of these buyers, rather than to provide additional consideration to Trapper. See SOR at 4, 7-9; SOR to Director, MMS, at 11-13; Response to RVSD's Field Report at 5. 13/ We also accept that it was "commercially reasonable" for Trapper to deliver and for Colorado-Ute et al. to accept the coal in an uncrushed condition. (SOR to Director, MMS, at 15.) However, none of this changes the fact that, regardless of which party to the contract did the crushing, it was necessary to do so in order to place the coal in a condition suitable for the general market in the area. MMS must, in accordance with the applicable regulation, look to that market to determine the proper value for royalty purposes. Cf. United States v. Southwest Potash Corp., 352 F.2d 113, 116-18 (10th Cir. 1965), cert. denied, 383 U.S. 911 (1966) (potash properly valued for royalty purposes according to customary market prices paid for refined products rather than contract sales price when sold as crude ore); California Co. v. Udall, 296 F.2d at 387-88 (uncompressed and untreated natural gas); Xeno, Inc., 134 IBLA 172, 182-83, 184 (1995), appeal filed, Xeno, Inc. v. Babbitt, No. CV-95-142-GF-PGH (D. Mont. Dec. 26, 1995) (ungathered and uncompressed natural gas); R.E. Yarbrough & Co., 122 IBLA at 221-22 (ungathered and uncompressed natural gas); Davis Exploration, 112 IBLA 254, 259 (1989), aff'd, Davis v. Lujan, No. 90-CV-0071-B (D. Wyo. Apr. 29, 1991), aff'd, No. 91-8030 (10th Cir. Apr. 8, 1992) (unblended crude oil); FMC Corp., 54 IBLA at 80-81 (unfinished soda ash).

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fn. 12 (continued)
do not consider the sales contracts associated with two out of seven mines in the Green River Hams Fork region as "typical" for that area, where that word is commonly defined as "[e]xhibiting the traits or characteristics peculiar to its kind, class, group, or the like; representative of a whole group." (The American Heritage Dictionary of the English Language 1388 (New College Edition 1976).) Nor can we say that these two contracts indicate what is "normally" expected by buyers or "typical[ly]" done by sellers of coal in the region. 54 Fed. Reg. 1498 (Jan. 13, 1989).

13/ Trapper argues, with supporting affidavits, that it was not necessary from a practical standpoint for Trapper to primary crush the coal in order to transport it by truck from the mine to the crushing facility at the Craig Station, that it was cheaper for Colorado-Ute et al. to crush the coal at their existing facility than for Trapper to construct and operate a new facility at the mine, and that crushing at their facility allowed Colorado-Ute et al. to control the crushing and to maintain a steady supply for their electric power generating operations. None of these assertions persuades us that the crushing was in fact done solely at the expense of Colorado-Ute et al., with no reimbursement by Trapper in the form of a lowered sales price.

Trapper further argues that MMS cannot properly include the cost of primary crushing in gross proceeds, for royalty valuation purposes, when there is no evidence that its proceeds are actually "`reduced'" because Colorado-Ute et al. are providing crushing as a service to Trapper. (SOR at 11, 12 (quoting from 30 C.F.R. § 206.257(h) (1990), emphasis deleted).) At best, such proof could only be obtained by relying on the statements of the parties involved in the transaction. However, this would render the collection of Federal royalty dependent on the reliability of statements made by those parties. We do not regard that approach as tenable. Looked at another way, Trapper in effect requires that MMS prove that, were the primary crushing cost not borne by Colorado-Ute et al., the contract sales price paid by them would in fact be increased. While this seems likely, given the fact that the price exacted under the 1973 Fuels Agreement was based on cost factors, see 1973 Fuels Agreement at 22-38, it cannot be established with certainty. See Peabody Coal Co., 139 IBLA at 172. Indeed, in most cases, this would be an almost impossible burden since it would require MMS to prove a hypothetical concerning the supposed future business dealings of third parties.

In any event, we hold that such proof is not required by 30 C.F.R. § 206.257(h) (1990). It is sufficient, under the regulation, that MMS establish that primary crushing is necessary to place the coal in a "marketable condition," and that this cost would ordinarily be borne by the lessee. When such a showing is made, the gross proceeds received by the lessee will be deemed to have been reduced for royalty valuation purposes pursuant to 30 C.F.R. § 206.257(h) (1990), in order to avoid exacting any portion of the cost of primary crushing from the Federal Government. That is the situation here.

We, thus, conclude that the preponderance of the evidence establishes that, regardless of what coal Colorado-Ute et al. were willing to accept, primary crushing of the coal sold from Trapper's leases was necessary to place that coal in a generally "marketable condition," within the meaning of 30 C.F.R. § 206.251 (1990). 14/ Thus, we agree with MMS that the primary crushing cost must not be borne, to any degree, by the Federal Government, by excluding that cost from the "gross proceeds" accruing to Trapper as a result of the various sales to Colorado-Ute et al. In the words of 30 C.F.R. § 206.257(h) (1990), those proceeds "shall be increased to the extent that [they] ha[ve] been reduced because the purchaser[s] * * * [are] providing [a] service[], the cost of which ordinarily is the responsibility of the lessee to place the coal in marketable condition." Cf. United States v. Southwest Potash Corp., 352 F.2d at 116-18.

14/ We particularly note that the mere fact that the coal must be primary crushed before it could be used by Colorado-Ute et al. in their electric power generating operations supports the other evidence that it was not in an acceptable market condition prior to doing so. See Field Report at 17; Response to RVSD's Field Report at 6 ("Trapper has never contested the need to crush coal before it is used").

To the extent not expressly addressed herein, all other arguments of fact or law asserted by Trapper have been fully considered and rejected as either contrary to the facts or law or immaterial.

The Deputy Director in her September 1993 Decision properly affirmed the determination of MMS that the cost of primary crushing should be included in gross proceeds for royalty valuation purposes, in the case of sales of coal from Trapper's leases from March 1, 1989, to August 15, 1990.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the Decision appealed from is affirmed.

Gail M. Frazier
Administrative Judge

I concur:

R.W. Mullen
Administrative Judge